

Risk Management

Managing a Family Budget

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Budgeting for family income and expenses is often a lower priority for farm and ranch families than budgeting for the business. Without budgeting, however, family living expenses may exceed the available income and jeopardize the overall financial goals of the farm and family. The management of family expenses within a set of mutual family goals can help to keep money from slipping needlessly away. Some reasons producers do not devote more time to managing family finances include:

- They are not tax deductible.
- Family budgeting is difficult and time consuming.
- Compared to farm/ranch expenses, family living expenses are too small to worry about.
- Non-farm income pays for family expenses so it doesn't matter.

Many producers devote attention to family living expenditures only once a year—at loan renewal time. To approve an operating loan, many lenders require that the borrower provide an estimate of family living costs, either as an annual total or broken down by expense category. Producers may rarely go back and compare their actual family living expenses against their budgeted amounts.

Why Develop a Family Living Budget

Budgeting for family expenditures is the foundation of a sound financial management plan. When used in conjunction with records of actual spending, a family budget allows you to pinpoint unnecessary spending and areas where actual costs may be higher or lower than you previously thought. Given the tight profit margins in agriculture, adhering to a finely tuned family budget can give a much needed boost to your financial future. Not having a family budget means you are not managing your family finances. This most often leads to spending more money than you realize in some areas. Managing a family budget can also allow you to discover ways to put your money to better use, such as debt reduction, retirement savings, or college savings. The most difficult part of managing a family budget is having the discipline to dedicate enough time each month to managing it.

Family Goals and Standard of Living

Before developing your family budget, you must first determine your farm and family goals, and the standard of living your family desires. It is important that all members of the family be involved in this goal setting process

so that the goals reflect the perceptions and ambitions of each member of the family. Open communication is important in this process. When establishing family goals, be as realistic as possible and consider all available income. Setting unattainable family goals will cause much unnecessary frustration and render the process less effective.

The financial goals of your family can be divided into two categories—short-term and long-term. Short-term goals are those you hope to achieve in the coming year, while long-term goals are those you hope to achieve further into the future and that usually require substantial financial resources. Examples of short-term goals are replacing the washer and dryer or trading in the family car. Examples of long-term goals include saving for your children's education, saving for retirement, and paying off the farm/ranch.

Standard of living is mostly perception. What one person or family perceives as being a lavish lifestyle may seem frugal to someone else. The standard of living your family desires can be something you want now, or it can be a goal to strive for in the coming years. Do you want to drive a \$40,000 vehicle or a \$15,000 vehicle? Do you want to live in a \$250,000 house or a \$65,000 house? How frequently do you want to dine out at an expensive restaurant—twice a week, once a month? These are the kinds of standard of living questions you need to address.

Family Records

The best way to develop an accurate family budget is to be very familiar with your current and past expenses. If you have not been keeping good records, developing a budget will be more difficult. You may be doing one or a combination of the following: 1) drawing an amount from the farm checking account to pay family living expenses each month; and/or 2) using non-farm income to pay all or a portion of family living expenses. In either case, you can probably review past bank statements and pay check stubs to determine how much money you spent each month for family living expenses. After determining this amount, list the expenses you incur

each month that are known, or fixed. These could include child-care, car payment(s), house payment(s), cable/satellite TV, auto/life/home/medical insurance, and others. After establishing these amounts, subtract the total of these known expenses from the total amount the family spent. The remainder will be those expenses that vary from month to month. These will include expenses such as groceries, dining out, gifts, utilities, clothing, entertainment, travel, home maintenance, medical care, auto fuel, and others. Next, based on your memory, cashed checks, and other records you may have, allocate the remainder to the family living expense categories that vary from month to month. Start with expenses for travel, home maintenance, and medical care, since these expenses tend to occur less frequently than the others. For the others, you'll have to use your best judgment in allocating to these categories. Try to recall any amounts that were intended to be used for family living expenses but were instead transferred to the farm account (and/or non-farm business account) or used to service farm debt. Overlooking these types of transactions could cause your family living expenditures to be vastly overestimated.

Developing Your Family Budget

If you have been keeping good family records, building a budget is much simpler because you know your past spending patterns. Whether you are building the budget based on an estimate of past costs or on actual costs, keep in mind that your past lifestyle, goals and standard of living may or may not be the same as the way you plan to live in the future.

You can budget on an annual basis, monthly basis (cash flow), or a monthly average. Use a method that is most useful to you. If your income fluctuates from month to month, a monthly budget will probably be most useful. Since most bills are due on a monthly basis, most people find a monthly budget more useful.

Budgeting Income

To begin, list all sources and estimated amounts of income you expect to have available for family expenses during the year. These include salaries, interest income, rental income, dividends, non-farm business income, etc. If some portion of farm income is to be used for family living (which is typical), estimate an amount you plan to set aside for family living. You may have to adjust these amounts before you're satisfied with your budget.

Budgeting Expenses

Since there are so many types of family living expenses, determine the categories that are meaningful to you and your family. For simplicity, they should be consistent with the categories you use in your record-keeping system. Refer to Table 1 for examples of expense categories. The next step is to budget an amount for each of your expense categories that reflects the goals, lifestyle and desired standard of living you have established.

Example

Jack and Jane Farmer are not happy with their current financial situation and have decided to take a closer look at their family expenditures. They have been using some of their equity to pay for family expenses. Here are a few facts about the family:

- The Farmers have been keeping pretty good family living records.
- The Farmers have a 6-month-old son.
- They farm full time and have a medium-size cow/calf operation. After all farm expenses and loan payments are paid, \$18,000 is available for family living expenses.
- Jane works off the farm and has annual take home pay of \$36,000. The Farmers also earn a small amount of interest income each year.
- They are satisfied with their current standard of living but they think they can achieve it at a lesser cost.
- They would like to invest in both a retirement fund and a college savings fund. They don't know how much money they have available for either one.

The Farmers began developing their family budget. To keep the budgeting process as simple as possible, they list only the net amount (take home pay) of Jane's salary. The taxes withheld from Jane's salary adequately cover the tax liability incurred by the salary. They estimate an additional \$3,000 in taxes is due on their farm. The Farmers' family living records are pretty good, but not perfect. Knowing this, they review the past 12 months of records and make a few corrections. They then make estimates for the budget based on the past 12 months of records, keeping in mind that during the most recent 6 months, they have had a child.

It is important to use budget categories that make sense to you and your situation. In the example budget in Table 1, the variable expense items can vary significantly from month-to-month. The Farmers know they can be flexible, if needed, on clothing and dining out for example. And, they know it's impossible to accurately predict some expense items such as medical and auto repairs. One way to manage this is to set aside, each month, the budgeted amounts for auto repair and medical expenses. Then, when those expenses do arise, the money is there to pay for them. The *discretionary cash* category is a residual amount. After working with the budget and determining the amount for each expense category, including retirement investments, the Farmers arrived at \$255 per month for discretionary cash that would make the budget balance, and they felt that this was a reasonable amount for this category. For the Farmers, discretionary cash is dedicated to paying for all of those expenses that arise each month that are difficult to budget, such as gifts, lawn and landscape maintenance, and household repairs, just to name a few. The Farmers also set aside \$125 each month for Christmas gifts.

When developing your budget, you also need to think about the major expenses you will have in the future, some of which may be 10 or 20 years in the future. We are talking about expenses other than college and retirement cost of living. These can include things like replacing the roof on your house, paying for your daughter's wedding, buying your kids a car when they reach that age, just to name a few. Estimate

these types of expenses, and then determine how much you need to save each month (or year) in order to have enough cash in savings to pay for these expenditures when they occur. The Farmers' budget in Table 1 does not have a budgeted amount for these types of long-term expenses.

Table 1. Example monthly average family living budget.

Income	Monthly	Annual
Salary (take home)	\$3,000	\$36,000
From farm acct.	\$1,500	\$18,000
Total income	\$4,500	\$54,000
Fixed expenses		
Car payment	\$427	\$5,124
Child care	\$475	\$5,700
House payment	\$1,043	\$12,516
Retirement account	\$400	\$4,800
Insurance	\$200	\$2,400
Taxes	\$250	\$3,000
Total fixed expenses	\$2,795	\$33,540
Variable expenses		
Auto fuel	\$225	\$2,700
Auto repair	\$75	\$900
Clothing	\$70	\$840
Contributions	\$275	\$3,300
Dining out	\$75	\$900
Groceries	\$325	\$3,900
Medical	\$50	\$600
Telephone	\$105	\$1,260
Utilities	\$125	\$1,500
Christmas (save)	\$125	\$1,500
Discretionary expenses	\$255	\$3,060
Total variable expenses	\$1,705	\$20,460
Total expenses	\$4,500	\$54,000
Net surplus/deficit	\$0	\$0

Budget Surplus or Deficit

When developing your budget, if you find that you have a budget surplus, consider doing some or all of the following:

- Make sure you have not underestimated some of your expenses or overestimated income.
- Apply the surplus to debt.
- Reinvest the surplus in the farm.
- Invest the surplus in a retirement fund or college savings fund.
- Increase your standard of living and/or family goals.

Don't be alarmed if the first attempt at building a family budget reveals a budget deficit. The steps below will help you determine how to alleviate a deficit:

- Make sure you have not drastically overstated any of the expenses or underestimated income.
- Re-evaluate your family's goals and desired standard of living. You may need to lower them.
- Determine whether you can decrease expenses while still meeting your goals and standard of living. You will more than likely have to make some tough choices to accomplish this.
- Determine whether you can generate more income. If you can, then determine if it will be enough to cover the deficit. If it is more than enough, you will need to determine how you want to spend the excess (surplus).

Making the Budget Work

Working with family living budgets can be interesting and very rewarding if you perceive it as a challenge, and recognize the personal economic benefits achieved from a successful budget. Budgeting is not a one-time event, but rather an ongoing exercise in pursuit of your financial goals. To accomplish the goals you have set, you should monitor your actual expenditures and compare them to your budget once or twice a month, if not more. The most difficult part of managing a family budget is having the discipline to do it.

Managing a budget and keeping records is tedious enough, so try to avoid “watching every penny” and being distracted with irrelevant details. A good effort at keeping records and managing your family living budget will go a long way toward enhancing your financial future.

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